

UKIP PARLIAMENTARY RESOURCE UNIT

Defence procurement revisited: The work of the SSRO



Defence procurement revisited: the work of the SSRO

Duncan Simpson

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Outline

Since its establishment in 2014, the Single Source Regulations Office (SSRO) has increased oversight of defence procurement, delivering some savings and efficiencies. However, the Secretary of State for Defence has hindered it from making greater savings by restricting its remit. The Ministry of Defence's (MoD) control over the SSRO necessarily compromises its independence. To fulfil its remit, the SSRO should therefore be responsible to the body elected to hold the executive to account: Parliament.

The remit of the SSRO

The SSRO performs a necessary function because the challenge is so acute: defence procurement in this parliament and the next will constitute an outlay of £178bn by the UK government. Single-source procurement, that which is not put out to tender and is generally ordered from one large company, will carry a book value of up to £100bn between 2015 and 2025¹.

To this end, the SSRO was established in 2014 to review (some of) the contracts awarded to defence firms in the absence of market conditions. This represented the first update to how non-competitive contracts are awarded and calculated since the 1960s.

The SSRO's remit, as laid out in the Defence Reform Act 2014, stipulates that it must ensure good value in non-competitive 'qualifying defence contracts' and that single source suppliers are paid a "fair and reasonable price"². This entails setting a maximum profit rate as a proportion of pre-determined allowable costs for defence contractors, and overseeing a consistent accounting regime to establish this.

The function of the SSRO, however perfunctory, sheds light on an area of government spending that has long suffered from poor financial management, and defence ministers and officers suffering from contractor capture.

¹ SSRO Annual Compliance Report 2015, January 2015, Page 5

² Defence Reform Act 2014, Page 9

SSRO Successes

Since its inception, the SSRO has had, within the confines of its remit, some notable successes.

The amount that defence firms can extract from taxpayers has been diminished. This maximum, or baseline, profit rate for defence contractors has been reduced from 10.6% to 8.95% for the 2016/17 financial year by the Defence Secretary, following the SSRO's recommendation.

Related to this are cash savings that the SSRO has brought about on behalf of taxpayers. £11.9m of savings have been confirmed in its first year of operation, and £61m of potential non-allowable costs are under investigation³. To buttress this work, the SSRO have updated their guidance on what they deem an allowable cost, to preclude marketing for exports and faulty workmanship during reworks.

The SSRO has also exposed clear breaches of public trust by UK defence contractors. For instance, their investigations showed that £32,500 was claimed by a defence contractor for a charitable donation and another firm charged the Ministry of Defence £34,000 for "staff welfare", which included a Christmas party⁴.

Of the 34 Qualifying Defence Contracts (QDCs) which were examined by the SSRO in 2015/16, 90% were found to have data of a quality that was deemed an area of significant concern. 21% of the report submissions were not made within the statutory guidelines⁵. In spite of the small amount of reports which they were allowed to examine, the SSRO is, so far, successfully highlighting defence contractors' negligence.

MoD resistance

The SSRO would be a more effective body if it were not held back by the ministers and poor implementation of the Defence Reform Act.

The accountabilities are confused. The SSRO can review reports which describe how final prices were arrived at, but it is not able to disallow agreed contracts. Equally, when highlighting wrongdoing in its compliance statements and reports, it is able to show evidence of poor data provision, but does not name individual companies that this applies to.

³ SSRO Interim Compliance Statement, July 2016, Page 3

⁴ "Defence groups challenged over charges for parties and donations", Financial Times, 13/7/16

⁵ SSRO Interim Compliance Statement, July 2016, Page 3

The arms-length nature of the SSRO's work means that their ability to uphold the Defence Reform Act and the Single Source Contract Regulations is inhibited by civil servants and contractors' lack of desire to effectively engage with them. The creation of the SSRO, a quango removed from, but ultimately responsible to, the MoD, has limited the efficacy of the Act. As a consequence, taxpayers cannot take much confidence from the new system of oversight as it presently stands.

The SSRO lacks the capability to punish defence contractors for transgressions and abuse of taxpayers. The Ministry of Defence is also unwilling to punish. In their Interim Compliance Statement of July 2016, the SSRO said that "to date, we are not aware of any compliance notices or penalty notices having been issued by the MoD."

More important still are the information asymmetries which permeate the whole process. The Defence Secretary can exempt contracts from SSRO scrutiny, the SSRO cannot review agreed contracts between MoD procurement officials and contractors, and contractors "do not always comply with the requirement to describe the facts, calculations, information or assumptions that support the inclusion of Allowable Costs or the calculation of the contract profit rate." Collectively, this severely limits the SSRO's utility.

Conclusions and recommendations

The SSRO currently has a limited remit and is constrained in its power over defence contractors. Though it is a new body, too often, the MoD is unwilling to proffer sufficient information or act on the advice of the SSRO. The recent departure of its chairman, Clive Tucker, is further evidence of this.⁶ Ministers should not act when it is convenient for them. Instead, parliament, through the SSRO, should be the overseers of the Ministry of Defence.

This would ensure that the SSRO would have genuine power and independence from government. The UKIP PRU has already called for the Defence Select Committee to oversee all major defence procurement projects and the work of the MoD's procurement arm, Defence Equipment & Support. Their purview and expertise would be enhanced with oversight of the MoD's contract negotiations.

The Framework Document between the SSRO and the MoD should be re-drafted, so as to ensure responsibility to parliament, and the Ministry of Defence should no longer serve as the sponsoring Department.

⁶ 'Second boss of defence spending watchdog quits', The Times, October 25 2016
(<http://www.thetimes.co.uk/article/second-boss-of-defence-spending-watchdog-steps-down-slzcx0cx7>)

Other key recommendations include:

- **All contracts and sub-contracts which are agreed without a competitive process should be scrutinised by the SSRO.** The current legislation stipulates that only Qualifying Defence Contracts and Qualifying Sub-contracts beyond a certain threshold should be subject to SSRO oversight. The Defence Secretary also has the power to exempt contracts from scrutiny. The legislation should be updated to remove both of these qualifiers.
- **Transparency of defence contractors' agreements with DE&S must be increased.** Presently, the SSRO does not receive copies of the contracts agreed between DE&S and the contractors, only a report detailing their audit trail and pricing calculations to verify. All single-source contracts should be available to the SSRO and members of the Defence Select Committee.
- **The SSRO needs to be awarded enforcement powers.** The SSRO can only serve as an arbiter of disputes, and recommend financial penalties for poor provision of data by contractors. Better defined statutory punishments need to be laid out if defence contractors do not meet the reporting requirements contained within the existing Act or regulations.